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THE TAXATION OF INCOMES IN OKLAHOMA

I. A BRIEF HISTORY OF INCOME TAX LEGISLATION IN OKLAHOMA

Oklahoma passed its first income tax May 26, 1908, shortly after its admission as a state of the Union. The law required the assessor, at the time of making the assessment of real and personal property, to demand of each person a statement of his income in so far as it exceeded \$3,500. The blank to be filled out contained this question, "Was your gross income from salaries, fees, trade, profession and property upon which a gross receipt or excise tax has not been paid, any and all of them for the year ending June 30, last preceding, in excess of \$3,500?" If the answer was in the affirmative the person filled out a blank certifying the amount of the taxable income, the assessor also signed the blank, then forwarded it to the state auditor, who in turn certified the amount of the tax due to the proper county clerk. The tax was then extended on the rolls in the same manner as other property. The township assessors were required to furnish the state auditor a list of all persons subject to the tax and who had made the declaration together with the names of other persons who, in their opinions, might be liable for income tax. The state auditor was given power to subpoena witnesses and to take other steps to ascertain whether such persons ought to make returns.¹

The rates were levied on gross incomes of persons except in the case of incomes derived from property upon which a gross receipt or excise tax had been paid. The following table² illustrates the gradation of rates employed.

Amount of Taxable Income			Rate
From	\$ 3,500 up to	\$ 5,000.....	$\frac{1}{2}$ of one per cent
In excess of	5,000 and up to	10,000.....	$\frac{3}{4}$ of one per cent
In excess of	10,000 and up to	20,000.....	$1\frac{1}{5}$ per cent
In excess of	20,000 and up to	50,000.....	$1\frac{1}{2}$ per cent
In excess of	50,000 and up to	100,000.....	2 per cent
In excess of	100,000.....		$3\frac{1}{3}$ per cent

The revenue derived from this tax was added to the common school fund. It was unlawful to print or publish in any manner any income

¹ Kennan, K. K., *Income Taxation*, p. 225.

² Revised Statutes of Oklahoma, 1910, Vol. II, Art. XVII, sec. 7532, p. 2049.

tax return or any part thereof, and penalties for false swearing or failure on the part of the assessor to perform his duty were provided. However, in spite of these precautions the law was a complete failure, as far as producing revenue was concerned. The following figures indicate that the law was well-nigh universally ignored.¹

Year	The Revenue Produced by the Income Tax Law of 1908
1909.....	\$2,816
1910.....	4,913
1911.....	4,671
1912.....	4,834

In 1912 the state auditor recommended that the law be either thoroughly revised or repealed. In 1915 the legislature made a drastic revision of the whole law, virtually enacting a new income tax law.

II. OUTSTANDING FEATURES OF THE PRESENT OKLAHOMA INCOME TAX LAW

The 1915 law was similar in many respects to the federal act. However, in view of the fact that the law is the result of many compromises, it does not exactly follow any particular mode. It provides for a graduated income tax upon the net income of individuals only; it does not apply to the incomes of corporations as do some of the other state income tax laws. Private corporations and banks are assessed upon the net value of their moneyed capital,² surplus and undivided profits, as the same is entered on the first day of March, and the assessed valuation of any real estate located in the state owned by the corporations and listed separately.

The properties, equipment, etc., of oil and gas companies are subject to the general property tax. In addition to the ad valorem tax on property and assets, common carriers, public utilities, oil and gas companies pay a gross revenue tax, the rate varying according to the nature of the service performed. Those corporations which do not pay a production income or gross receipt tax pay a license fee varying with the size of their capital. The rate is higher on foreign than on the domestic corporations. The present personal income tax is an addition to the other taxes, as no credit is allowed for other taxes

¹ Comstock, Alzada, *American Economic Review*, X, 2, p. 263.

² "Moneyed capital" includes money actually invested in the business whether represented by certificates of stock.

which have been paid. The income of municipal bonds of the state of Oklahoma is taxable under the income tax law.¹

The law applies both to residents and to non-residents who receive a taxable income from Oklahoma sources. The income tax blank sent out by the auditor indicates ten possible sources for gross income, viz., (a) salaries and wages; (b) professions and vocations; (c) business, trade, commerce, or sales or dealings in property, "whether real or personal"; (d) rents; (e) interest on notes, mortgages, bonds, bank deposits or evidence of debt of any kind whatsoever; (f) dividends on stock of corporations, joint stock companies and associations; (g) fiduciaries (income received by guardians, trustees, executors, administrators, agents, receivers, conservators or other persons acting in a fiduciary capacity); (h) partnership gains and profits whether distributed or not; (i) royalties from mines, oil wells, patents, franchises or other legalized privileges; (j) all other sources not enumerated.

Section one of the act states that each and every person in the state shall be liable to "an annual tax upon the entire net income of such person arising or accruing from all sources during the preceding calendar year, and a like tax shall be levied, assessed, collected and paid annually upon the entire net income from all property owned and all other business, trade or profession carried on in this state by persons residing elsewhere." In order to determine the net income, it is necessary to subtract certain allowable deductions from the gross income. Under "General Deductions" the income tax blank provides for seven classes of deductions,² viz., (a) the amount of all necessary expenses actually paid within the calendar year for which the return is made, in carrying on any individual business. This item must not include personal, living, or family expenses. Amounts paid for permanent improvements or betterment of property are not proper expense deductions. Donations are not proper deductions according to the income tax blank; (b) all interest paid within the year on personal indebtedness; (c) all state, county, school, and municipal taxes paid within the year—not including those assessed against local benefits and federal income tax; (d) losses actually sustained during the year incurred in trade, or arising from fires or storms and not compensated by insurance or otherwise. Payments for oil and mining leases are termed investments and not proper deductions if the lease

¹ *Bunn's Annotated Supplement of the Revised Laws of Oklahoma*, sec. 7302, p. 1023.

² Oklahoma State Income Tax Blank, S.E. & I. Form 1247. (1922.)

is still held. In connection with this item the taxpayer is required to show three facts; viz., (1) of what the loss consisted; (2) when it was actually sustained; and (3) how it was determined to be a loss. The knowledge of these facts gives the auditor a check and no doubt aids him in determining the accuracy of the report; (e) debts due to the taxpayer actually ascertained to be worthless and charged off at the end of the year. In connection with this question he is required to state four facts, viz., (1) when the debts were created; (2) of what the debt consisted; (3) when the debt became due; (4) how they were actually determined to be worthless. These data are to be presented on a separate sheet. (f) An amount representing a reasonable allowance for exhaustion, wear and tear of property arising out of its use or employment in business. The auditor's instructions specifically prohibit the deducting of wear and tear, gasoline and upkeep on pleasure cars. The taxpayer is required to give two facts in connection with this item, viz., (1) what the property was on which depreciation was taken; if buildings, the date of construction, material used, and the value as of January 1st of the calendar year for which the report is made, must be given; (2) what per cent of depreciation is claimed. The 1921 amendment provided that depletion on mines and oil wells should be computed under the rules and regulations in force and from time to time adopted by the Department of Internal Revenue of the Government of the United States. In no case, however, may a greater depletion amount be allowed the taxpayer by the state of Oklahoma than is allowed by the United States Government against federal income taxes upon identical property.

From the net income computed as described above, the taxpayer is allowed certain other deductions, viz.,

- a) A specific exemption of \$3,000 to an individual;
- b) However, if the individual is living with his or her spouse an additional exemption of \$1,000 is allowed. In other words the two are allowed a total exemption of \$4,000.
- c) In addition to the above exemptions, the taxpayer is entitled to an exemption of \$300 for each child under the age of 18 years.
- d) For each child and every person for whose support the taxpayer is legally liable, an additional exemption of \$500 is allowed while the child or person is engaged in acquiring an education, while only \$200 additional is allowed in all other cases.¹

¹ The taxpayer is to state on a separate sheet, when he returns his income blank, (a) the number of dependents; (b) the age of each; (c) the number engaged solely in acquiring an education, and (d) the legal liability of the taxpayer to support each of the dependents.

Having computed the total net taxable income by subtracting the sum of the general deductions and the specific exemptions from the gross income, the present law provides that the net income tax shall be computed in the following manner, viz.,

- a) On the first \$10,000 in excess of the exemptions and deductions 7½ mills;
- b) On the next \$15,000 in excess of the exemptions and deductions 15 mills;
- c) On all amounts in addition to (a) and (b) 20 mills on the dollar.

The tax is computed by adding together the amounts payable under each of *a*, *b*, and *c*.¹ These rates are much lower than the rates in the original law of 1915. The following table gives a summary statement of the development of the present graduated scale, i.e., the scales of the laws of 1908, 1915, and 1917.

1908*			1915		1917	
Amounts in excess of	and less than	Rates (Mills)	Amounts	Rates (Mills)	Amounts	Rates (Mills)
\$ 3,500	\$ 5,000....	5	First \$10,000...	10	First \$10,000...	7½
5,000	10,000....	7½	Next \$15,000...	20	Next 15,000...	15
10,000	20,000....	12	Next 25,000...	30	All amounts in excess.....	20
20,000	50,000....	15	Next 50,000...	40		
50,000	100,000....	20	All amounts in excess.....	50		
100,000 and above....		33½				

* The 1908 rates were on the gross income while the 1915 and 1917 rates apply to net incomes. In any case the tax was computed by adding together the amounts payable under each of the classes.

These various schedules of graduated scales indicate that the legislature of Oklahoma has been experimenting in order to find the most satisfactory combination of rates and amounts subject to the various rates. The 1915 law provided an initial rate which was regarded as too high while the number of classes was greater than circumstances warranted. As a result in 1917 the legislature reduced the number of classes from five to three and at the same time reduced the initial rate from ten mills to seven and a half mills and cut the maximum rate from fifty mills to twenty mills. As a result of these changes the effectiveness of the tax was greatly reduced. While the tax retained its graduated features the greater burden fell upon the incomes between \$4,000 and \$30,000, as all incomes in excess of the first \$25,000 of taxable incomes paid a flat rate of 2 per cent. As compared to other state income tax laws, the Oklahoma statute provides for a much higher exemption, i.e., \$4,000 for a married couple, \$300 additional for each dependent and \$500 additional if the dependents are engaged in getting

¹ Session Laws of 1915, Chap. 164, p. 286 f.

an education. The legislature was probably influenced in setting its exemptions high by the presence of many people in the state with relatively high incomes derived from the oil industry, while the relatively low incomes of the masses were not taxed. The high cost of living in the state no doubt also influenced the legislature in making the exemptions high.

The law makes no specific provision for the exemption of gifts or of proceeds of life insurance policies, as is done in some of the state income tax laws. Evidently these incomes must be counted as part of the gross income as Article XVII, sec. 7537e, subsection *f*, states, “. . . and all other income of any kind derived from any source whatever, except such as is exempt from taxation hereunder by some law of the United States or of this state,¹ shall be included in the term ‘income.’”

Non-residents receive the same treatment as residents as far as their property in Oklahoma is concerned. The Supreme Court of the United States decided that a state may impose an income tax on the income accruing to non-residents from their property or business carried on in the state. Therefore the Oklahoma Law is not invalid for want of jurisdiction.² It was also decided that the Oklahoma law does not deny non-residents the privileges and immunities to which they are entitled and the equal protection of the law; in fact it permits residents to deduct from their gross income losses incurred within or without the state, while non-residents may deduct only those incurred within the state. Thus non-residents are taxed only on their income from sources within the state while residents are taxed on the income from all sources.

The law makes no provision for credit for taxes paid by a resident on income received from without the state which may have already paid a tax. He must pay on his entire net income. Thus a person living in Oklahoma who receives part of his income from property in Missouri would be forced to pay two state income taxes upon the same income, provided of course that it was large enough to be classed as taxable income. On the other hand if he lived in Missouri he would be allowed—under the Missouri income tax law—an offset for a certain amount paid in Oklahoma. When the law was first passed there was objection that it was unconstitutional because it provided for taxation

¹ *Bunn's Annotated Supplement*, p. 1028.

² In *Shaffer v. Carter*, 252 U.S. 37.

of incomes from oil property which property was already paying a gross production tax. The U.S. Supreme Court¹ held that even if the income tax constitutes double taxation, as applied to producers of oil and natural gas, paying a gross production tax, it does not violate the Constitution so long as such taxation is not based on arbitrary distinctions. In the case of gains of partnerships the taxpayer must count the gains as part of his income whether they are distributed or not. The amendment of 1921 allows a deduction not to exceed 15 per cent on the taxpayer's net income for charitable donations.

Administration of the income tax law is in the hands of the state auditor, who provides the blanks which are filled by the taxpayer and returned to the auditor's office. If any person liable under the law fails or refuses to make, or if he makes a false return the state auditor may give him 10 days' notice to appear before him in his office with books of account showing the condition of his business during the year. If the individual refuses to do this, the auditor may apply to the District Court of Oklahoma County or any judge thereof for an order requiring compliance. If it is found that the person has been guilty of attempted fraud or evasion, there is added to his tax as a penalty, \$5 per day for each and every day the person has refused to comply—after March 15. Each individual's report must be filed on or before March 15, in the auditor's office. The 1915 law set March 1 as the date, however, in order to bring the state date as near as possible to the date for making the federal income tax return, the change was made. The tax becomes due June 15, and is delinquent if not paid on or before July 1.

The effect of the change in the law in 1915 is clearly shown in the change in the amount of revenue received. The revenue for 1910, 1911, and 1912 was \$4,915, \$4,671, and \$4,834, respectively, while the revenue collected in 1915 and 1916 amounted to \$250,000 and \$400,000, respectively. However, the amount collected in 1916 was only 1.5 per cent of the entire amount of tax revenue collected in Oklahoma, yet it was greater than the total revenue produced by the income tax during the preceding seven-year period.² If the receipts from the state income tax are compared with the receipts by the federal government from personal incomes in Oklahoma, the latter tax appears much more productive, i.e., the federal government collected \$4,347,797 in 1916, \$5,682,493 in 1917, \$7,649,280 in 1918, and

¹ *Ibid.*

² Comstock, Alzada, *American Economic Review*, X, 2, p. 262.

\$12,207,129 in 1919. That is, the federal government received approximately ten times as much revenue from personal incomes in Oklahoma in 1916 as the state. In 1919, 3.03 per cent of the population made returns to the federal government, reporting an average net income per return of \$3,937.96 with an average amount of tax paid per return of \$198.49. In 1918 there were 7,009 returns on incomes from \$3,000 to \$4,000, 4,688 returns on incomes from \$4,000 to \$5,000, 1,721 returns on incomes from \$5,000 to \$6,000, and 1,010 returns on incomes from \$6,000 to \$7,000. The number reporting returns was much greater in 1918 than in 1916; for instance, there were only 384 returns in the \$3,000 to \$4,000 class in 1916. In view of the great increase in returns and in the amount of the tax in the case of the federal income tax, it might be expected that the state income returns and collections would show the same great increase. Whether this is true or not cannot be stated as the reports of the state auditor are not available. Repeated attempts have been made by the writer to secure these data. But the legislature of Oklahoma failed to make an appropriation for the publication of the auditor's report in sufficient quantities for distribution, and private correspondence likewise brought no information. The general impression, however, seems to be that the state income tax is not producing nearly as much revenue as it should. The high exemptions and the low rates in themselves would cause a relatively low yield. The administration of the tax by the auditor's office, without special district officers to aid in applying the law in the various localities, leads to evasion and consequently to a low yield and unsatisfactory results in general.

To summarize, the Oklahoma income tax law provides for a graduated tax, with comparatively low rates and high exemptions, on the net personal incomes of both residents and non-residents. The administration of the tax is entrusted to the state auditor. The 1908 income tax law proved a failure as a revenue producer, while the present law has brought in much more revenue. But owing to inadequate machinery for administration and to the high exemptions and low rates, this law has not produced the amount of revenue which its proponents expected.

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